The New System of Taxation
of intellectual property rights in Cyprus

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In May 2012 Cyprus introduced a package of incentives and tax exemptions relating to income from intellectual property rights, aimed at stimulating investment in research and development. A number of other countries, including Luxembourg, the Netherlands, Ireland and the United Kingdom have already introduced such schemes, which have come to be known as an intellectual property box ("IP box"). By introducing an IP box Cyprus hopes to consolidate its position as a hub for the cross-border holding and exploitation of intellectual property rights.

The amendments to the Income Tax Laws are effective from 1 January 2012 and apply to all expenditure for the acquisition or development of intangible assets incurred by a person carrying on a business. The amendments effectively apply to all categories of intellectual property.

The main features of the new IP box are as follows:

Five year amortisation period

The cost of acquisition or development of an IP right may be capitalised and amortised on a straight line basis over five years, giving an annual writing down allowance of 20 per cent.

This is a considerable acceleration compared with the previous amortisation regime, in which rates were determined by reference to the estimated useful life of the underlying asset. For example, if a patent had a validity of 20 years its useful life would be deemed to be 20 years and the annual writing down allowance would be 5 per cent.

The acceleration of writing down allowances will result in substantial cash flow benefits by reason of the reduction and deferral of tax liabilities, especially where the value of the IP asset is substantial.

80 per cent exemption of profits from exploitation of IP rights

Four-fifths of the profit earned from the use of intangible assets (including any compensation for improper use) is disregarded for tax purposes.

Since any dividend income generated paid to non-resident shareholders is exempt from Cyprus tax of any description a Cyprus company can be used to generate royalties under licensing or similar arrangements with third parties and-distribute profits to its shareholders by way of dividends with minimal tax leakage.

80 per cent exemption of profits on disposal of IP rights

Four-fifths of any profit resulting from the disposal of relevant intangible assets is disregarded for tax purposes.

While this may be a useful exemption in certain circumstances, in most cases full exemption from tax can be achieved by holding the assets concerned in a separate company and disposing of the shares in that company, rather than the assets themselves.

Overall, an effective tax rate of less than two per cent, the lowest by far in the EU

The amount subject to tax under the new rules is calculated by deducting the writing down allowance, the costs (including interest) of financing the acquisition or development of the assets and any other direct expenses from the revenue earned, and dividing the resultant amount by five. Applying the Cyprus corporate income tax rate of 10 per cent produces an effective tax rate of two per cent of the net income. Given that generous deductions are available against gross income, the overall effective rate should generally be well below two per cent.

This is much lower than the competition: the United Kingdom “patent box” regime

gives an effective rate of 10 per cent on relevant income. The Irish scheme is more compare rates, but it will generally produce a rate close to the UK rate. The Luxembourg and Netherlands schemes are somewhat better, with effective tax rates of 5.76 per cent and 5 per cent respectively, but they are both considerably poorer than Cyprus.

Advantages and savings compared with the previous regime

Before the introduction of the IP box it was generally necessary to have a company incorporated and resident in a zero-tax or low tax jurisdiction as the IP owner, which would license the use of the IP rights to a Cyprus-resident company, which in turn would sub-license their use to end-users, preferably registered and tax resident in a country with a double tax treaty with Cyprus.

Following the introduction of the IP box, there is no longer any need to have a separate IP owner outside Cyprus. In addition to tax savings, eliminating a corporate layer in a different jurisdiction will save administrative and compliance costs.

Conclusion

The new regime provides very attractive opportunities for structuring the exploitation of IP assets through Cyprus and in particular through the use of Cyprus-resident IP owners, especially in the context of Cyprus's extensive network of double tax-treaties under which foreign withholding taxes on royalty income are either elimi

In most cases immediate economic and tax savings can be achieved by transferring intellectual rights currently held by entities located in low or no tax jurisdictions to Cyprus resident companies in order to take advantage of the new exemptions. The transfer of IP rights into a Cyprus company will not give rise to any form of taxation in Cyprus and the new benefits and substantial exemptions will become available as soon as the asset is transferred. ~

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